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UNCLAS SECTION 01 OF 02 PRAGUE 000500

SIPDIS

SENSITIVE

STATE FOR EUR/NCE, EUR/ERA AND EB/CIP
COMMERCE FOR 4232/ITA/MAC/MROGERS

E.O. 12958: N/A
TAGS: ECPS EINV EZ EUN
SUBJECT: HIGH PRICE FOR CESKY TELECOM PLEASES CZECH
GOVERNMENT

REF: 04 PRAGUE 1790

¶1. Summary: (U) The Spanish telcommunications firm Telefonica will pay $3.6 billion for Cesky Telecom (CT), much more than the government had expected to get for its share of the company at the outset of the privatization process. Telefonica will have to offer to buy out the minority shareholders of CT, which will further raise its investment in the company. Some experts question the impact of Telefonica's expansion on its finances. The purchase is expected to generate some synergies in mobile telephone, internet and data services. The privatization process was generally deemed to have been conducted in a fair and transparent manner. The unexpectedly high price justified the government's decision in December to offer CT to strategic investors before putting the shares up for sale on the Prague Stock Exchange. End Summary.

¶2. (U) The Czech government took a break from its protracted crisis on April 6 and unanimously approved the sale of state-owned Cesky Telecom, along with its subsidiary Eurotel, to the Spanish telecoms operator Telefonica, Telefonica agreed to pay the government Kc 82.6 billion ($3.6 billion) for its 51.1% controlling share. This sum exceeded government expectations by as much as 20-30 billion crowns -- up to $1.3 billion. The failed attempt to sell CT in 2002 brought an offer of only Kc 50 billion ($2.1 billion). This year's result justified the government's decision to offer CT to strategic investors before turning to the capital markets, over the objections of Finance Minister Sobotka and to the disappointment of local investment powerhouse PPF (reftel).

¶3. (U) Swisscom reportedly offered Kc 79 billion, and Belgacom Kc 67.4 billion. Telefonica will be required to offer to buy the shares of CT's remaining shareholders, institutional and individual. It is hard to say how many shareholders might sell out, but it could cost Telefonica as much as another $3 billion if it has to buy all the outstanding shares. The purchase of CT marks a new direction for Telefonica, which has heretofore concentrated on customers in Latin America. CT's 3.3 million fixed lines and Eurotel's 4.6 million mobile phone customers will add only a small amount to Telefonica's 43 million fixed lines and 74 million mobile customers worldwide. Nevertheless, the handsome sum paid by Telefonica will have to be financed, and the Standard and Poor's credit rating agency second-guessed Telefonica's expansion plans by placing its current A- rating on "creditwatch negative". Telefonica will pay the government Kc 502 per share compared to the current market value of the shares of Kc 400.

¶4. (U) CT has little room to grow in its fixed-line business. Telefonica is expected to bring expertise and advantages in data and broadband internet services, into which CT has only just begun to venture. Telefonica's experience in international mobile systems may help to improve Eurotel's roaming services and hasten the introduction of third generation UMTS services. On the other hand, CT's experience with new EDGE high-speed mobile internet services could benefit Telefonica. Telefonica's new Czech subsidiary may even provide a base for expansion into other Eastern European markets.

¶5. (SBU) The CT sale has been under close scrutiny because of previous unfortunate experiences in the Czech Republic with privatization of major state-owned companies. This sale was swiftly concluded and relatively unencumbered by special conditions that seemed to unfairly favor one or another bidder, as has been the case in other privatizations. A source close to the privatization told us that the current government's political crisis actually helped to keep the privatization process fair and transparent by discouraging back-room dealing that would have compounded the government's problems if revealed. However, they added that the due diligence process uncovered some unseemly deals by the current CT management in the course of CT's and Eurotel's day to day business. As a result, Telefonica intends to replace all but one or two of the current managers. These managers, headed by CEO Gabriel Berdar, will still enjoy generous "golden parachutes" as they exit.

¶6. (U) In the small Czech economy, sales such as that of CT have a measurable impact on the currency if not handled carefully. The Czech crown is already under constant upward pressure due to financial inflows. Therefore, the government has agreed that the purchase price will be paid in euros and held in a special account in the Central Bank. Some will be expended to pay off debts in the off-budget transportation and housing funds, and at the National Property Fund. The rest the government plans to hold as a reserve for future efforts at pension reform. The Prague Stock Exchange had hoped that a sale through it would jump-start interest in the capital market here, and is therefore disappointed that did not happen. As it is, there exists a possibility that the shares of CT (and the recently privatized petrochemical firm Unipetrol) will be pulled from the exchange by the new owners, which would further reduce the handful of actively traded share issues on the exchange.
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